SEPTEMBER 23, 1985 THREE DOLLARS

Forbes

IS GOLD THE ONLY ANSWER?

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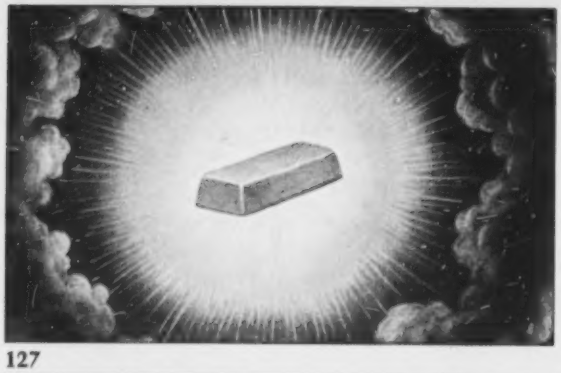
Forbes

September 23, 1985
Volume 136
Number 8



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September 23, 1985 Volume 136 Number 8 Forbes (ISSN 0015 6914) is published biweekly except weekly during two weeks in April, two weeks in September and two weeks in October, by Forbes Inc., 60 Fifth Ave., New York, N.Y. 10011. Second-class postage paid at New York, N.Y. and at additional mailing offices. Subscription $42 a year, U.S.A. Postmaster: Send address changes to Forbes, 60 Fifth Ave., New York, N.Y. 10011.

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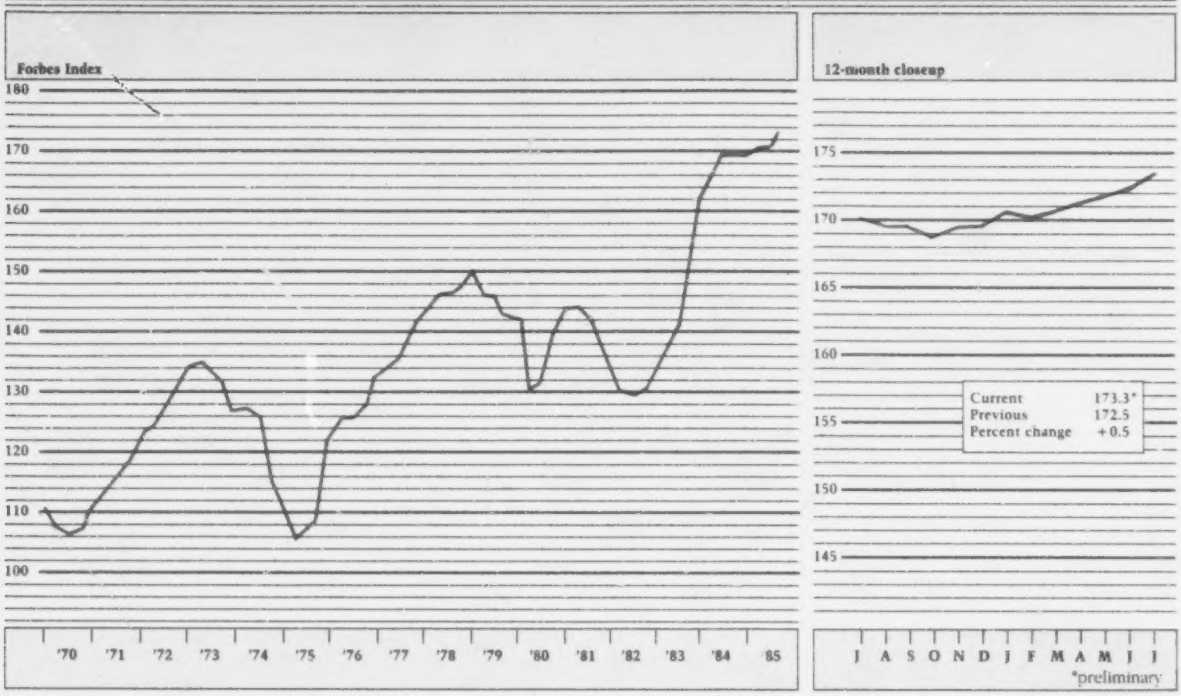
Cover illustration by Kinuko Craft

The Forbes Index



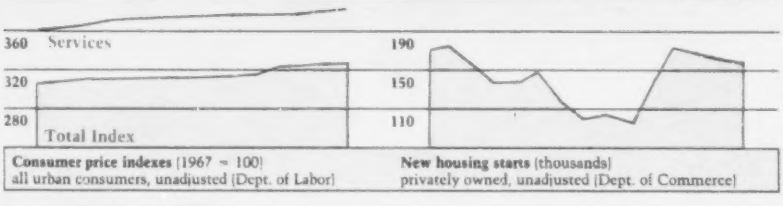
Inflation is still not a problem. M1 may be growing faster than targeted earlier by the Fed, but there is little evidence that it is putting inflationary pressure on the economy. The overall Consumer Price Index shows a less than 0.2% increase over the previous month—on an annualized basis, an inflation rate of only 1.9%. Last June the CPI pointed to an annual inflation rate of 3.7%.

Inventories crept up 0.5% while manufacturers' new orders showed a 2.8% month-to-month decline. Even so, the total of new orders for the most recent three-month period was some 1.2% higher than it was one month ago. Thus, as calculated in the Forbes Index, the relationship between new orders to inventories still had a positive impact. This helped push up the Forbes Index 0.5%.

The Forbes Index Components

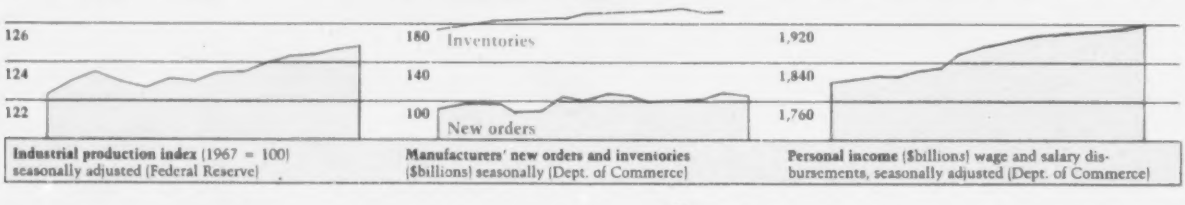
The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, Forbes monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



Consumer price indexes (1967 = 100) all urban consumers, unadjusted (Dept. of Labor)

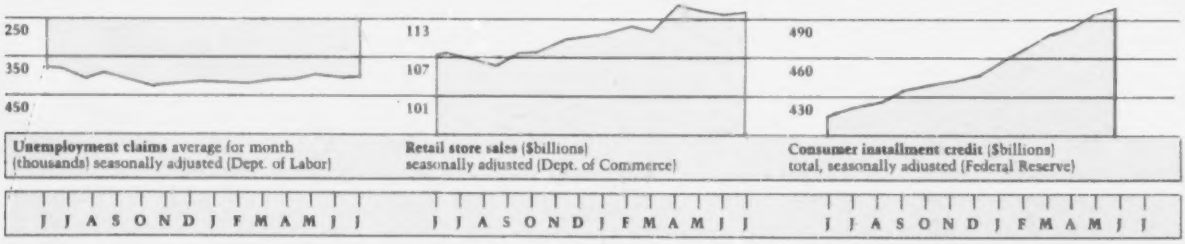
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)



Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)

Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)

Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



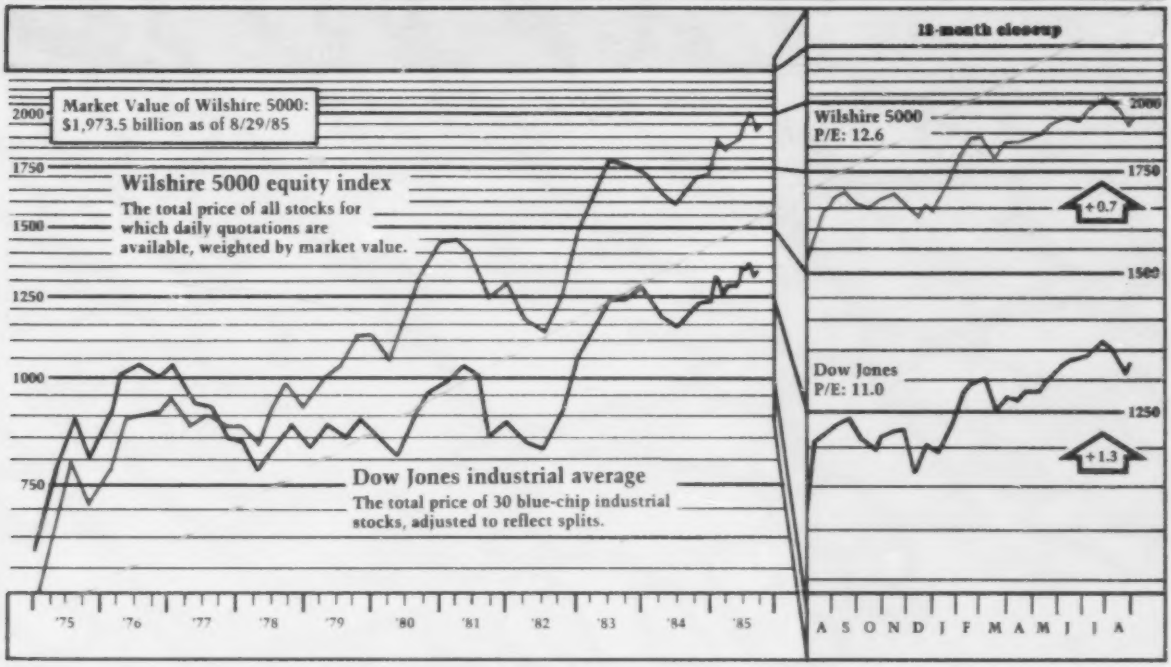
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)

Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)

Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen


12-month closeup
Market Value of Wilshire 5000: $1,973.5 billion as of 8/29/85
Wilshire 5000 equity index
The total price of all stocks for which daily quotations are available, weighted by market value.
Dow Jones industrial average
The total price of 30 blue-chip industrial stocks, adjusted to reflect splits.
Wilshire 5000 P/E: 12.6
Dow Jones P/E: 11.0
+0.7
+1.3
2000
1750
1500
1250
1000
750
'75 '76 '77 '78 '79 '80 '81 '82 '83 '84 '85
A S O N D J F M A M J J A

No fireworks. Wall Street ended the summer on a quiet note. Most of the excitement was provided by a handful of companies involved in takeover plays and firms like Mesa Petroleum, Union Carbide and Westinghouse with plans to restructure or buy back. On the NYSE daily trading volume averaged a modest 100 million shares.

But the apparent lethargy masks the fact that stocks were quietly making a comeback from their sharp declines of early August, when, in one day, the Dow fell almost 22 points and the Wilshire index lost nearly $25 billion in market value. Blue chips, predictably, recovered faster than secondary issues. The Dow ended the two-week period less than 25 points away from its mid-July high. All the Dow needs is a 1.9% gain to match its peak. Meanwhile, the Wilshire would need to rise 3.6% ($70 billion) to reach its previous top.

Closeup On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[1]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	–1.6	–1.7	–1.5	–1.5	–0.1	–2.2
in last 52 weeks	14.9	16.4	9.1	14.3	9.1	16.8

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[2]		P/E multiple		Dividend yield		Growth profile[3]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	–1.5	–0.5	–0.7	0.5	–1.8	–1.2	0.0	0.0	0.0	–0.6	–1.3	–1.3
in last 52 weeks	18.5	20.2	21.5	31.4	11.1	28.8	26.8	24.0	19.5	28.5	26.1	6.9

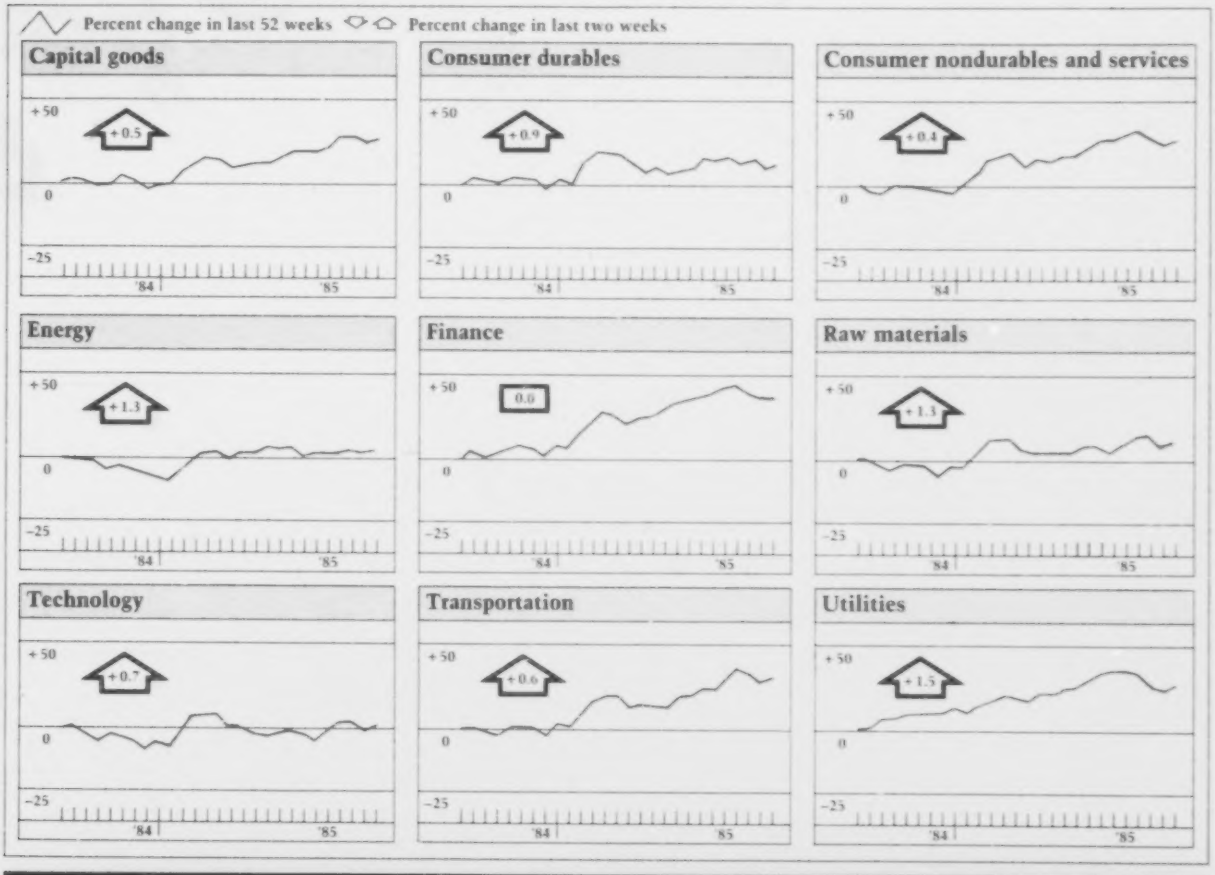
[1]Based on sales.
[2]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable.
[3]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 8/29/85. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

Hidden in the averages. The finance sector ended the two-week period unchanged. But a handful of major finance shares finished the last ten trading days with healthy advances. Leading the list was E.F. Hutton, which, aided by takeover speculation, rose more than 19%. Paine Webber, another brokerage firm, was also among the top five performing large-capitalization finance stocks.

All other groups posted minor gains. The best performing sector in the past two weeks, utilities, had several losers. Wall Street particularly shied away from power companies with significant financial or regulatory problems. Kansas Gas & Electric fell almost 19%. Middle South Utilities and Long Island Lighting lost nearly 12% and 9%, respectively.



What The Analysts Think

The cheapest stocks around. While the Forbes Sales 500 sell at 10.2 times estimated 1985 earnings, the consumer durables sector is selling at only a 7.7 multiple. That means these shares are priced even lower than utility stocks. If the anticipated cyclical decline does not materialize, venturesome investors could be rewarded.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$3.46	11.5
1985 estimates	3.89	10.2
1986 estimates	4.50	8.9

Rank based on change in estimate	Sector	Estimated 1985 EPS	Estimated 1985 P/E	% change in 1985 estimate in 2 weeks	% change in 1985 estimate in 4 weeks
1	Finance	$3.20	10.1	-0.03%	-0.02%
2	Consumer nondurables	2.43	12.9	-0.20	-0.19
3	Utilities	3.37	8.0	-0.34	-0.52
4	Energy	3.51	8.4	-0.96	-1.42
5	Consumer durables	4.91	7.7	-1.04	-0.7
6	Capital goods	2.92	10.3	-1.43	-1.72
7	Raw materials	1.94	13.0	-1.63	-3.13
8	Transportation	2.59	10.6	-1.71	-2.4
9	Technology	2.55	13.3	-2.22	-3.44

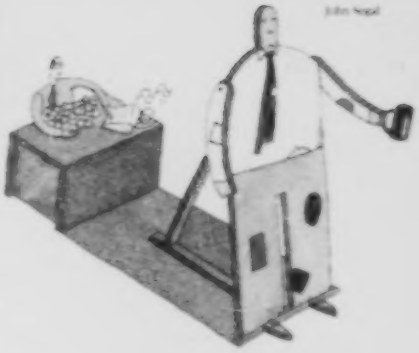
Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continuously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 8/29/85. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.

Statistical Spotlight

A tax-loss carryforward can be a hidden asset, especially if held by a company with extra cash or untapped borrowing power.

Losers, keepers



By Leslie Pittel

WANTED: real-estate-related operating company with large net operating loss," read a recent advertisement in the *Wall Street Journal*. Trafficking in tax-loss carryforwards? Who, me?

The IRS has rules to prevent what it calls trafficking in losses. A tax loss isn't supposed to be traded around as if it were a load of steel or a vacant lot. But, stepping carefully around these rules, wheeler-dealers do treat losses as an asset that can add value to a company. So do smart stock pickers.

Look at Circuit City Stores, formerly Wards Co. The $519 million (fiscal 1985 sales) electronics retailer bought moneylosing and bankrupt Lafayette Radio Electronics in 1981. Circuit City has used Lafayette's carryforwards to shelter some of its earnings. Since then earnings per share have grown at a 106% rate and the stock price is up more than 12-fold.

It also works the other way. A firm with a tax-loss carryforward and a healthy balance sheet can buy other, profitable firms. The management can run the firm tax-free until the tax benefits run out.

Pantry Pride's recent attempt to take over Revlon was predicated on the former's loss carryforward, accumulated during its years as a not very successful grocery chain. Wickes Cos. came out of Chapter 11 bankruptcy in January with almost $500 million in loss carryforwards and a healthy balance sheet. In June it paid over $1 billion for Gulf & Western Industries' consumer and industrial products group. Shelter from the Wickes losses could save around $80 million a year on the former G&W operations.

Losses are not invariably useful. "A tax-loss carryforward isn't worth a damn unless it's backed by a good financial position," says Marty Whitman of M.J. Whitman & Co., a New York City investment firm. Adds Lee Seidler, a general partner with Bear, Stearns in New York City, "Even as-

Risk rewarded

Four years ago the 42 firms listed here were moneylosers, but they all had juicy tax-loss carryforwards. A portfolio of these risky stocks would have gained an impressive 80%, vs. 39% for the Wilshire 5000 index.

Company	% change	Company	% change
Allied Supermarkets	141%	MCI Communications	164%
American Airlines (AMR Corp)	221	McLouth Steel	–100
American Motors	–38	Memorex*	4
RL Burns (Pyro Energy)	–9	National Tea*	50
CI Mortgage Group*	35	The Outlet*	102
Cenco	–99	Pan American	64
Chicago Milwaukee	242	Penn Central	70
Chrysler	441	Pier 1	680
Commonwealth Oil Refining	–100	Republic Airlines	49
Eastern Air Lines	21	Sambo's Restaurants	–100
Fedders	–33	F&M Schaeffer*	6
First Pennsylvania	44	Seatrain Lines	–50
Food Fair (Pantry Pride)	73	Singer Cos	120
Genesco	–43	Teleprompter*	11
Great Atlantic & Pacific Tea	198	Todd Shipyards	24
Grolier	119	UNC Resources	–23
International Harvester	–54	United Merchants & Mfrs	167
Itel	41	Western Air Lines	–27
Jonathan Logan*	295	Wheeling-Pittsburgh Steel	–70
Leucadia National	818	White Motor (NE Ohio Axle)	–72
LTV	–63	Wyly (UCCEL)	31
Average	80%		
Wilshire index	39%		

*Acquired or went private.

suming that a firm got to use the tax-loss carryforward, the most it would be worth is whatever the tax rate is, say 46%." If uncertainties abound, a dollar of loss may be worth not 46 cents but only 5 or 10 cents.

Companies have 15 years to make use of their carryforwards before they expire. But the tax rules can, in certain cases, deny use of a loss carryforward if there is a big change in the taxpayer's line of business or stock ownership. "You have to prove to the IRS that you really want the business and not just the tax benefits," says John Adams, president of Smith-Vasiliou Management Co. in New York City. The laws on tax-loss carryforwards are complex and changing. Congress rewrote the laws in 1976, but since then it has repeatedly postponed the effective date of the new laws. There might or might not be a second rewrite.

A few years ago FORBES ran a list of troubled firms with large tax-loss carryforwards *(Apr. 13, 1981)*. Many of them were able to put those tax credits to good use. On average the group is up 80%, vs. 39% for the market, as measured by the Wilshire 5000.

The list, updated, appears on page 214. Leucadia National, a diversified financial firm, scored the biggest turnaround, with an 818% stock price gain. Then there's Pier 1. In 1979 Newcorp, a former REIT that was working its way out of bankruptcy, acquired Pier 1 for $36 million in cash and eventually changed the name of the merged company back to Pier 1. In part using the tax-loss carryforwards from Newcorp, Pier 1 earnings have climbed smartly and its stock is up almost 700%.

Herewith a new list *(below)* of loss leaders. Most of the companies are plausible turnaround candidates or have large cash positions, so the loss carryforwards will probably not go to waste. Texas Air, with its chief subsidiary, Continental Airlines, in Chapter 11, has more than $190 million in unused losses. The company recently made an apparently unsuccessful attempt to take over Trans World Airlines. Chicago Milwaukee Corp., after selling its interest in the Milwaukee Railroad this year for $587 million, is left with substantial real estate properties, timberlands, and tax-loss carryforwards of $178 million.

But don't forget that large tax-loss carryforwards alone are not always enough. McLouth Steel, Sambo's Restaurants and Seatrain Lines went bankrupt, and common shareholders received little or nothing back on their investment. Investors are still behind 60% or more in LTV, Wheeling-Pittsburgh Steel and White Motor (Northeast Ohio Axle). ■

Lures and traps

Some of the firms listed here are emerging from bankruptcy. Others still teeter on the brink. But all have a lure—significant tax-loss carryforwards that can shelter future income for up to 15 years. That's the catch, of course. Of what use are carryforwards if there are no profits to be offset?

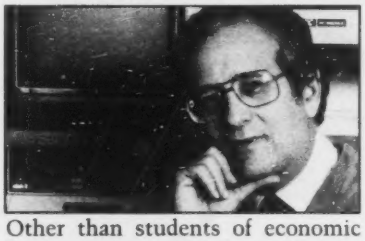
Exch	Company/business	Price recent	Price 52-week high	Price 52-week low	Tax loss/ share	Latest 12-month EPS	Cash ($million)	Current ratio	Sales ($million)
a	AM International/office equip	3⅞	5⅜	2½	$5.09	$0.87	$ 33.7	1.40	$ 598
p	Allied Supermarkets/supermarkets	5¼	6	2⅜	3.39	–0.08	38.1	2.36	530
n	Bethlehem Steel/steel	17½	21	14⅜	26.40	–3.52	127.0	1.07	5,392
p	Central Jersey Inds/bank equip, vending	24⅝	29¼	7⅛	47.77	0.95	12.3	2.61	56
n	Chicago Milwaukee/multicompany	135	199	130	72.59	0.42	200.0*	1.87	159
o	Chicago Pacific/real estate	29¾	30½	24	11.77	5.93	254.0	23.01	96
p	City Stores/retail	7⅜	8½	6	31.64	0.17	11.8	6.69	4
n	Danaher/tire and rubber	8⅜	9½	5½	11.82	0.41	2.7	1.00	91
o	Doskocil/food processing	1½	2	1	1.20	0.06	4.7	2.85	104
o	Equion/auto parts	5⅝	7	4⅜	1.08	0.83	0.3	2.04	40
o	Itel/leasing	8⅛	8⅝	2⅞	21.57	–0.51	61.0	NA	195
ps	Lionel/toys†	5¾	5¾	3⅜	3.66	1.43	3.1	3.30	355
n	Mestek/engineering svcs, comp equip	3⅞	4⅜	2½	22.96	nil	1.8	2.88	12‡
n	Natl Intergroup/diversified	28	33½	24¼	18.85	–2.43	203.0	2.86	2,294
n	Pantry Pride/supermarkets	6⅞	8	3⅜	8.21	0.12	32.8	2.31	770
n	Penn Central/multicompany	51¾	58⅝	43¾	53.96	4.24	37.1	1.75	2,569
o	Reading Co/real estate	21⅞	23⅜	15¾	49.28	0.16	20.4	2.05	25
n	Revere Copper & Brass/metal fab†	14⅝	14⅞	10	17.33	6.44	108.5	8.30	601
a	Texas Air/airline	18⅜	19¾	6⅝	14.69	2.97	317.0	2.25	1,372
n	Tiger Intl/freight transport	7¼	10⅛	5¾	17.81	–4.46	152.0	0.93	1,209
o	Triton Group/multicompany	1¾	1⅞	1¼	3.35	NA	1.8	1.81	9**
n	US Steel/steel	30⅜	31⅛	22½	10.23	1.61	292.0	1.17	19,104
n	Wheeling-Pittsburgh Steel/steel†	8⅝	24⅛	6⅝	12.90	–28.76	NA	NA	1,050
a	Wickes/retail	4⅜	5¼	2⅜	5.14	1.54	565.0	3.32	3,031

a: American Stock Exchange. n: New York Stock Exchange. o: over-the-counter. p: Philadelphia Stock Exchange. ps: Pacific Stock Exchange. *Estimate from *The Value Line Investment Survey*. †Company in Chapter 11 proceedings. ‡Fiscal 1983. **Eight months. NA: Not available.

One of the fundamentals of economics has taught OPEC a painful lesson: When you raise the price of something, people will learn to substitute or to do with less.

OIL SLICK

By Stanley W. Angrist



Other than students of economic history, who would have thought that the members of OPEC would be cheating each other blind only 12 years after their biggest triumph? How did this strange turn of events come about? At least some of the answers may be found in the table.

With the exception of the Soviet bloc, every sector of the world energy market has reduced consumption since 1979, and that decline does not appear to be over. U.S. consumption has dropped a tremendous 17% since 1979, and the story for this year is much the same.

What has caused this reduction in demand? Nothing more than simple economics at work. The higher prices that OPEC imposed on the world in the last 12 years are now working their long-range magic by way of conservation. But in addition to conservation, the world's economies are continuing to substitute other fuels—coal, natural gas and nuclear power—for oil. What's more, the economies of the OECD countries are growing most strongly in their service sectors, where little oil is used per unit of output.

The most striking thing to note from the production part of the table is where the cuts were made. In Saudi Arabia production has fallen from 9.6 million barrels per day (mbpd) in 1979 to an estimated 3.7 mbpd for 1985. The other OPEC members have seen their production drop from 21.9 mbpd to an estimated 13.6 mbpd. These 1985 estimates are by Paine Webber and could well be on the high side.

The Saudis are now threatening to play their trump card: unilaterally increasing production by 5 mbpd or so while simultaneously cutting their crude price by $5 to $10 per barrel. The idea being to shock the other OPEC members sufficiently so that in a couple of weeks they would abandon their nefarious ways and return to a cartel-dictated price.

Refiners have cut their purchases, thus keeping inventories at unusually low levels in anticipation of the Saudi action. Apparently, oil buyers are now doing for OPEC what the cartel cannot do for itself—stabilizing prices by cutting back on the volume purchased, forcing additional production cuts.

One way to play this waiting game is by means of a bear spread in crude. Currently, in the oil market the near months sell for more than the distant, reflecting relatively low inventory levels. If the Saudis play their trump card, the nearby contracts will fall much more sharply than the distant ones, since the shock treatment would not be expected to last long. So I would try to sell November and buy January crude, with the November carrying at least a 25-point premium to the January. The margin on this trade is about $750; the round-turn commission, $50 at a discounter.

This trade has the potential to be a big winner if the Saudis do their number. I would look for a minimum 200-point profit ($1,000 per spread), risking no more than 50 points ($500 per spread) from my entry price. If this trade works at all, it won't take very long to reach its price objective. ■

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Conservation blues

Oil consumption has declined steadily since 1979, and production has had no choice but to follow suit. OPEC—and Saudi Arabia in particular—has had to absorb all of the cuts, while other producers, such as Britain, Norway and Mexico, have gained market share at its expense.

World oil production*	1979	1980	1981	1982	1983	1984	1985†
US	10.1	10.2	10.2	10.2	10.2	10.4	10.6
USSR	11.9	12.2	12.4	12.4	12.5	12.4	12.4
Saudi Arabia	9.6	10.0	10.0	6.7	5.2	4.7	3.7
Other OPEC	21.9	17.5	13.4	13.2	13.3	13.6	13.6
Western Europe	2.4	2.6	2.7	3.1	3.5	3.8	3.9
Other	9.9	10.2	10.7	11.4	12.0	12.9	13.0
Total	65.8	62.7	59.4	57.0	56.7	57.8	57.2
World oil consumption*							
US	17.9	16.5	15.6	14.8	14.7	15.2	15.0
Soviet bloc	12.9	13.0	13.2	13.2	13.2	13.2	13.2
Western Europe	15.0	14.0	13.1	12.5	12.2	12.3	12.5
Other noncommunist	18.3	18.1	18.0	18.0	17.8	18.2	18.2
Total	64.1	61.6	59.9	58.5	57.9	58.9	58.9

*In millions of barrels per day. †Estimated by Paine Webber.

Source: *British Petroleum Statistical Review.*